V. Capitalization of Fixed (Capital) Assets, Uniform Capitalization Policy, Infrastructure and Depreciation

By far the most controversial element of Statements 34 is the presentation of fixed assets including infrastructure and their direct relationship to debt. For most component units, the financial statement transition to compliance with Statement 34 *is minor,* as your statements already include fixed assets and depreciation.

All historical treasures and works of art are now required to be "recorded," at the very least, for insurance purposes. **We have proposed that it is the policy of the Commonwealth <u>not to</u> depreciate historical treasures and works of art, but you still have to record them and account for their upkeep.**

a. Where do I get information regarding the historical cost of infrastructure and fixed assets?

The Commonwealth recognizes that all component units have records for assets are depreciating them. We ask you to ensure that all fixed assets are included in your audits. Commonwealth policy requires fixed (capital) assets to be recorded at historical cost. Where historical cost is unavailable after a thorough search of bond documents, capital appropriations, donor records, etc., a current replacement cost estimate can be used. Paragraphs 157 through 160 of the statement allow a deflation of replacement cost to historical cost using commonly available indices. **Please contact the Office of the State Comptroller if you need assistance in arriving at historical cost**.

b. What are Historical Treasures and Works of Art?

Statement 34 does not clearly define a historical treasure. **We have agreed that it is our policy that a historical treasure is a capitalizable asset that is not depreciable. It may be registered as an historical landmark, place, building, monument, etc.**

Works of Art are defined in two classes, those held for exhibition *and exhaustible* and those that are not. Works of Art that are **held for exhibition, education or research, those that are protected, cared for and preserved and those that, if sold, the proceeds must be used to acquire other artwork**, **are not** accounted for as fixed assets and therefore **are not** depreciated. Works of Art that are deemed *exhaustible,* irrespective of their exhibition, need to be depreciated, but their cost or donor value should be reported on the books of the entity. **We have proposed that it is our policy that historical treasures and works of art in the Commonwealth will most likely not be depreciated, but their upkeep must be recorded as an expenditure.**

c. What are the categories of fixed (capital) assets for the Commonwealth?

The following eight categories should be used, allowing for easy comparability between component units:

Not Depreciated -	Land Construction in Progress
Depreciable	Land Improvements Buildings Machinery, Equipment and Vehicles (including computers) Infrastructure Other

Your entity has the opportunity to add additional, material categories if needed.

d. The Commonwealth's Capitalization Policy

It is our goal to have a uniform capitalization policy for GAAP purposes. *For internal reporting purposes, your entity can continue to report in the manner approved by your Board of Directors / Trustees.*

Though *you are not required to follow it*, MMARS memo #290 provides guidance about the Commonwealth's capitalization policy:

- Departments are required to properly account for all fixed asset transactions. This includes the proper recording of and reconciliation of a periodic inventory of their Non-GAAP Fixed Assets.
- Physical inventories of fixed assets are completed annually as of June 30th of each fiscal year.
- **Non-GAAP Fixed Assets**

  Non-GAAP fixed assets are buildings and equipment, including computer software, with a useful life of more than 1 year and an original cost between $1,000 and $14,999.99, and all electronic and computer components**.**
- **GAAP Fixed Assets**

  GAAP fixed assets are defined as all land regardless of cost, buildings and equipment, including computer software, with a useful life of one year or more, and an original cost of $15,000 or more. This includes **Construction in Progress** that will result in equipment, buildings or computer software that meet this cost criteria.

Other Assets

Due to the nature of business, other governmental entity requirements, sound internal controls, etc. the entity should determine if a lower capitalization threshold for the inventory for other assets under its control is appropriate. Assets acquired through Tax-Exempt Lease Purchase ("TELP") and capital leases are considered fixed assets at the time of acquisition.[10]

Currently, the Commonwealth's policy does not address infrastructure. After consulting with our external auditors, it is entirely permissible to have *different* capitalization levels for various types fixed assets. One could be for "vertical" or movable fixed assets and the other would be for infrastructure.

We have agreed to continue the policies of capitalization, but want to have a goal of uniform alignment. GASB 34 is a perfect time to do this. The *current* policies are as follows:

	Commonwealth Departments and Agencies
Land	All land
All other assets	≥$15,000 per unit

The capitalization level is currently under review. For example, buildings and equipment may be at $50,000 or higher. All vehicles may remain to be capitalized, no matter what level. We will inform all component units if the Commonwealth decides to change its levels.

e. Depreciation and Asset Lives

The Commonwealth's current asset life policy is put forth in the procurement handbook, released by the Operational Services Division (OSD.) A table is set forth for **vertical and movable fixed assets** in the appendix (B) to this guide. OSD's table is built off of Internal Revenue Service Publication 946, whose table B-1 is also included in the appendix to this guide. We recommend, unless you have strong evidence otherwise, that your entity use these asset lives as your policy.

In short, all items that are capitalized and are depreciable should be depreciated. **It is our policy to only use the straight-line depreciation method.** It is easy to understand and is rational in its basis.

Various asset lives as published by OSD are as follows:

[10] MMARS Memo 290, *Guidance on Non GAAP Fixed Asset Management MMARS*, June 30, 1999.

Buildings	27.5 to 40 years, depending on construction[11]
Building Improvements	20 years
Leasehold Improvements	5 years or the term of the lease, whichever is **greater**
Equipment (Non-Office)	10 years
Computer Equipment	3 years
Other Office Equipment	5 years
Life safety improvements	5 years
Motor vehicles	5 years
Used motor vehicles	3 years
Residential furnishings	3 years
Office furnishings	7 years

Other items from IRS 946 that you may have (not including infrastructure) are:

Land Improvements	20 years
Industrial Steam and Electric generation and distribution systems	22 years
Aircraft	6 years
Watercraft	20 years
Buses	9 years

The Commonwealth has an infrastructure workgroup as part of the implementation of GASB 34. The group has used internal guidance from the Massachusetts Highway Department, The Massachusetts Turnpike Authority and the Massachusetts Port Authority (Massport) as sources of the Commonwealth's policy on depreciating infrastructure. **For infrastructure depreciation, the following amounts useful lives are contemplated:**

NEW Roads and Other Horizontal Infrastructure	20 Years – Per MHD Design Engineers (Note that Massport depreciates the Mystic – Tobin bridge at 100 years and Masspike 50 years)
Betterments to Roads and Other Horizontal Infrastructure	10 Years – Per MHD Design Engineers
Port facilities – buildings and piers	25 years

Remember that depreciation is an estimate. If an asset **is sold, retired or lost due to a casualty before its useful life has ended, you must declare the disposition and record any gains or losses under GAAP.** In any such transaction, all accumulated depreciation to the date of the action must be removed.[12]

f. The Modified Approach to Infrastructure

[11] In an update to its capitalization policy, the Commonwealth will likely go to entirely 40 years.
[12] GASB 34, Paragraph 117 and Note 1, *Illustrative Disclosure of Information about Capital Assets* on page 245.

There is an alternative method of capitalization of infrastructure. Again, infrastructure includes, road systems, water and sewer systems and lighting systems. Paragraphs 23 – 26 of Statement 34 detail this approach. To be eligible for the modified approach, your entity must have an up-to-date inventory of infrastructure assets, must perform frequent condition assessments and summarize the results using a measurable scale and estimate the amounts needed yearly to maintain and preserve the assets at a proper level. These condition assessments must be made at least every three years and the condition of the roads must be disclosed. **It is the judgement of the Commonwealth <u>not to use this approach</u> due to a number of factors**.

- The cost to audit this method will be far in excess of the current projected cost under GASB 34 conditions, due to the need to verify the condition assessments.

- The disclosure of the condition of infrastructure may be subjective and potentially, politically motivated. The disclosures are detailed under paragraph 132 and 133 of Statement 34.

Because of the rules of GASB 14 and GASB 34, all entities that are component units of the Commonwealth must choose the same method as the Commonwealth. It is in our judgement that the traditional capitalization / depreciation method for infrastructure is proper.